

PERAC AUDIT REPORT



Essex Regional Contributory Retirement System

JAN. 1, 2003 - DEC. 31, 2005 / PERAC 05-5



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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KENNETH J. DONNELLY | JAMES M. MACHADO | DONALD R. MARQUIS | THOMAS TRIMARCO

JOSEPH E. CONNARTON, *Executive Director*

February 16, 2007

The Public Employee Retirement Administration Commission has completed an examination of the Essex Regional Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2003 to December 31, 2005. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

In our opinion, the financial records are being maintained and the management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiners James Ryan, Carol Niemira, James Sweeney, and James Tivnan who conducted this examination and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



Essex Regional Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

1. Accounting

In the previous PERAC audit covering the four-year period ending December 31, 2002, we recommended that the financial results reported by the investment manager's be compared and reconciled with the general ledger and custodian at least quarterly. The System still does not make use of the detailed statements issued by the investment manager's as its primary data source. This is a necessary test to confirm the accuracy of the financial results reported by the custodian.

In addition, fees charged and paid by direct deduction from the fund's market value, rather than payment by check, are not being accounted for separately. They are currently netted from the results of unrealized gains or losses. Since these fees are a direct expense to the fund, neglecting to properly account for them tends to understate gains and overstate losses attributable to these investments.

Recommendation: At least quarterly, pooled fund managers' statements should be reconciled to the custodian and general ledger for accuracy, taking any timing differences into consideration. Adjusting entries should be made to unrealized gains/losses reported by the custodian to account for pooled fund fees, where applicable (debit #5304 Management Fees, credit #4886 Unrealized Gains). The result will help ensure a more accurate performance calculation. The Essex Regional Retirement System's Annual Statement to PERAC must be modified to include these adjustments for pooled fund fees. These results are reported on Schedules 5 and 6 that are provided by the Custodian.

Board Response:

When the money managers submit their quarterly bills for the management fees, the balances on which they are billing are verified to the custodial statements for accuracy. We have begun using the detailed statements of the pooled funds to locate an[y] hidden management fees and make the proper adjusting entry so that our gains and losses are more fairly represented, however, many of the managers report on the entire fund, thus no breakout of the Essex Regional share. As we meet with them in the coming year, we will request that they make an adjustment to their contracts to allow for direct billing of management fees.

2. Cash

At the end of 2004 and 2005 the Eastern Bank checking account had a negative general ledger cash balance of (\$3,286.03) and (\$10,316.34), respectively. These negative balances were reported on Schedule 1 of the Essex Regional Retirement System's Annual Statement. According to the May 2006 bank reconciliation, the negative balance was (\$9,065.07).

Essex Regional Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

Recommendation: The Essex Regional Retirement System must transfer funds sufficient to cover any negative balances in their operating account. Banking agreements usually prohibit overdraft balances. Sound application of cash management planning will minimize the risk of checking account overdraft situations.

Board Response:

Since the checking account should be a zero-balance account, and since we know that at any given time there is an average of \$50,000 worth of outstanding checks at the end of the month, we do not feel it is a responsible thing to leave a large balance in a non interest-bearing account.

3. Membership

The auditor sampled retirees to determine if the superannuation calculations are correct and that the payroll matches the monthly allowance. In reviewing retiree files, it was noted that in seven out of thirteen Option C superannuation retiree files examined, the age of the beneficiary could not be verified. This issue was identified during the previous PERAC audit of the Essex Regional Retirement System.

Recommendation: The age of the Option C beneficiary is a critical component for the calculation of the retirement benefit. The System should confirm the precise age of the beneficiary by inspection of a birth certificate or other proof of birth date. A copy of the document should be included in the retiree's file.

Board Response:

All Option C beneficiary birth certificates have been re-filed.

4. System Administration

The auditor reviewed Board meeting Minutes for the period from January 2003 through the latest available, April 2006. Minutes from January 2005 extending through the latest available were provided in draft form. These were not yet signed by those Board members who attended each meeting.

Recommendation: In order to document the agreement of Board members to the proceedings at Board meetings and to attest to the integrity of the official record of each month's Minutes, the Essex Regional Retirement System must transcribe meeting Minutes in a timely manner. Draft copies of the minutes from the prior meeting should be circulated in advance to Board members for review and acceptance by signature at the subsequent meeting. In this manner, an accurate record of each meeting will be readily available as part of the public record.

Essex Regional Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

Board Response:

The Board is taking the necessary steps to ensure the minutes are filed and signed in a timely manner.

Final Determination

PERAC auditors will follow-up in six (6) months to ensure that the appropriate actions have been taken regarding all findings.

Essex Regional Retirement System

STATEMENT OF LEDGER ASSETS AND LIABILITIES

**FOR THE THREE YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

FOR THE PERIOD ENDING DECEMBER 31,				
ASSETS	2005	2004	2003	
Cash	\$4,598,850	\$37,792,267	\$6,116,137	
Short Term Investments	116,320	115,164	114,348	
Fixed Income Securities	103,680	27,244,533	26,483,477	
Equities	28,289,236	27,303,419	56,971,062	
Pooled Domestic Equity Funds	85,763,650	87,658,948	44,992,150	
Pooled International Equity Funds	37,256,265	20,834,931	17,584,240	
Pooled Domestic Fixed Income Funds	53,065,408	13,644,485	45,938,526	
Pooled Alternative Investment Funds	3,070,502	2,864,840	3,376,812	
Pooled Real Estate Funds	25,367,933	11,852,750	11,232,280	
Interest Due and Accrued	12,871	248,513	313,065	
Accounts Receivable	6,746,376	801,401	726,267	
Accounts Payable	(145,022)	(277,482)	(845,038)	
TOTAL	<u>\$244,246,069</u>	<u>\$230,083,769</u>	<u>\$213,003,325</u>	
FUND BALANCES				
Annuity Savings Fund	\$72,214,471	\$68,605,233	\$64,194,507	
Annuity Reserve Fund	24,268,564	22,072,299	21,448,779	
Pension Fund	8,691,887	12,602,519	17,117,934	
Military Service Fund	17,164	17,061	12,965	
Expense Fund	0	0	0	
Pension Reserve Fund	139,053,984	126,786,657	110,229,141	
TOTAL	<u>\$244,246,069</u>	<u>\$230,083,769</u>	<u>\$213,003,325</u>	

Essex Regional Retirement System

STATEMENT OF CHANGES IN FUND BALANCES

**FOR THE THREE YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

	Annuity Savings Fund	Annuity Reserve Fund	Pension Fund	Military Service Fund	Expense Fund	Pension Reserve Fund	Total All Funds
Beginning Balance (2003)	\$60,752,218	\$19,933,043	\$19,806,783	\$10,554	\$0	\$78,857,703	\$179,360,302
Receipts	9,045,548	595,960	13,335,185	2,410	1,486,535	31,370,860	55,836,498
Interfund Transfers	(3,499,778)	3,506,504	(7,304)	0	0	577	0
Disbursements	<u>(2,103,482)</u>	<u>(2,586,729)</u>	<u>(16,016,730)</u>	<u>0</u>	<u>(1,486,535)</u>	<u>0</u>	<u>(22,193,476)</u>
Ending Balance (2003)	64,194,507	21,448,779	17,117,934	12,965	0	110,229,141	213,003,325
Receipts	9,088,791	634,820	12,982,296	4,097	1,717,158	16,490,429	40,917,590
Interfund Transfers	(2,796,186)	2,729,098	0	0	0	67,088	0
Disbursements	<u>(1,881,879)</u>	<u>(2,740,397)</u>	<u>(17,497,712)</u>	<u>0</u>	<u>(1,717,158)</u>	<u>0</u>	<u>(23,837,146)</u>
Ending Balance (2004)	68,605,233	22,072,299	12,602,519	17,061	0	126,786,657	230,083,769
Receipts	10,037,455	668,565	14,652,138	102	1,813,075	12,276,710	39,448,046
Interfund Transfers	(4,394,282)	4,403,885	(219)	0	0	(9,384)	0
Disbursements	<u>(2,033,935)</u>	<u>(2,876,185)</u>	<u>(18,562,552)</u>	<u>0</u>	<u>(1,813,075)</u>	<u>0</u>	<u>(25,285,746)</u>
Ending Balance (2005)	<u>\$72,214,471</u>	<u>\$24,268,564</u>	<u>\$8,691,887</u>	<u>\$17,164</u>	<u>\$0</u>	<u>\$139,053,984</u>	<u>\$244,246,069</u>

Essex Regional Retirement System

STATEMENT OF INCOME

**FOR THE THREE YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

	FOR THE PERIOD ENDING DECEMBER 31,		
	2005	2004	2003
Annuity Savings Fund:			
Members Deductions	\$8,380,266	\$7,908,619	\$7,522,835
Transfers from other Systems	771,396	488,484	683,760
Member Make Up Payments and Redeposits	260,896	180,273	171,817
Member Payments from Rollovers	227,198	138,673	107,095
Investment Income Credited to Member Accounts	<u>397,699</u>	<u>372,743</u>	<u>560,041</u>
Sub Total	<u>10,037,455</u>	<u>9,088,791</u>	<u>9,045,548</u>
Annuity Reserve Fund:			
Investment Income Credited Annuity Reserve Fund	<u>668,565</u>	<u>634,820</u>	<u>595,960</u>
Pension Fund:			
3 (8) (c) Reimbursements from Other Systems	446,024	395,025	312,599
Received from Commonwealth for COLA and Survivor Benefits	1,247,449	461,210	568,253
Pension Fund Appropriation	<u>12,958,665</u>	<u>12,126,061</u>	<u>12,454,333</u>
Sub Total	<u>14,652,138</u>	<u>12,982,296</u>	<u>13,335,185</u>
Military Service Fund:			
Contribution Received from Municipality on Account of Military Service	0	3,913	2,410
Investment Income Credited Military Service Fund	<u>102</u>	<u>184</u>	<u>0</u>
Sub Total	<u>102</u>	<u>4,097</u>	<u>2,410</u>
Expense Fund:			
Investment Income Credited to Expense Fund	<u>1,813,075</u>	<u>1,717,158</u>	<u>1,486,535</u>
Sub Total	<u>1,813,075</u>	<u>1,717,158</u>	<u>1,486,535</u>
Pension Reserve Fund:			
Federal Grant Reimbursement	121,346	93,802	59,826
Miscellaneous Income	3,995	4,854	311
Interest Not Refunded	18,876	48,028	30,672
Excess Investment Income	<u>12,132,493</u>	<u>16,343,745</u>	<u>31,280,051</u>
Sub Total	<u>12,276,710</u>	<u>16,490,429</u>	<u>31,370,860</u>
TOTAL RECEIPTS	<u>\$39,448,046</u>	<u>\$40,917,590</u>	<u>\$55,836,498</u>

Essex Regional Retirement System

STATEMENT OF DISBURSEMENTS

**FOR THE THREE YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

FOR THE PERIOD ENDING DECEMBER 31,			
	2005	2004	2003
Annuity Savings Fund:			
Refunds to Members	\$1,300,374	\$1,245,453	\$920,236
Transfers to other Systems	<u>733,561</u>	<u>636,427</u>	<u>1,183,246</u>
Sub Total	<u>2,033,935</u>	<u>1,881,879</u>	<u>2,103,482</u>
Annuity Reserve Fund:			
Annuities Paid	2,844,594	2,598,192	2,422,768
Option B Refunds	<u>31,591</u>	<u>142,205</u>	<u>163,961</u>
Sub Total	<u>2,876,185</u>	<u>2,740,397</u>	<u>2,586,729</u>
Pension Fund:			
Pensions Paid			
Regular Pension Payments	13,806,107	13,004,480	11,878,170
Survivorship Payments	1,195,411	1,127,176	1,037,535
Ordinary Disability Payments	281,611	336,560	290,690
Accidental Disability Payments	2,114,484	2,012,159	1,832,263
Accidental Death Payments	625,628	584,702	574,044
Section 101 Benefits	71,145	56,522	64,454
3 (8) (c) Reimbursements to Other Systems	468,166	376,113	339,573
Sub Total	<u>18,562,552</u>	<u>17,497,712</u>	<u>16,016,730</u>
Military Service Fund:			
Return to Municipality for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:			
Board Member Stipend	15,000	15,000	15,000
Salaries	414,622	392,488	392,087
Legal Expenses	143,867	74,440	51,252
Medical Expenses	207	0	0
Travel Expenses	29,360	26,816	24,787
Administrative Expenses	135,871	127,896	125,988
Furniture and Equipment	14,859	8,495	10,717
Fiduciary Insurance	17,462	17,713	7,939
Service Contracts	23,030	25,173	15,907
Office Condominium Fees	21,984	17,355	15,985
Management Fees	829,137	836,983	664,613
Custodial Fees	85,428	82,109	92,535
Consultant Fees	<u>82,249</u>	<u>92,691</u>	<u>69,725</u>
Sub Total	<u>1,813,075</u>	<u>1,717,158</u>	<u>1,486,535</u>
TOTAL DISBURSEMENTS	<u>\$25,285,746</u>	<u>\$23,837,146</u>	<u>\$22,193,476</u>

Essex Regional Retirement System

INVESTMENT INCOME

**FOR THE THREE YEAR PERIOD BEGINNING JANUARY 1, 2003
AND ENDING DECEMBER 31, 2005**

	FOR THE PERIOD ENDING DECEMBER 31,		
	2005	2004	2003
Investment Income Received From:			
Cash	\$184,124	\$70,505	\$92,994
Short Term Investments	1,156	816	11,892
Fixed Income	2,140,658	1,546,050	2,254,139
Equities	214,766	537,921	786,684
Pooled Funds	1,583,461	2,394,120	2,713,253
Commission Recapture	<u>3,370</u>	<u>7,826</u>	<u>19,051</u>
TOTAL INVESTMENT INCOME	<u>4,127,535</u>	<u>4,557,239</u>	<u>5,878,013</u>
Plus:			
Realized Gains	2,092,909	2,982,799	6,548,871
Unrealized Gains	23,829,450	24,371,259	28,660,561
Interest Due and Accrued - Current Year	<u>12,871</u>	<u>248,513</u>	<u>313,065</u>
Sub Total	<u>25,935,230</u>	<u>27,602,571</u>	<u>35,522,497</u>
Less:			
Paid Accrued Interest on Fixed Income Securities	(585,766)	(205,771)	(309,179)
Realized Loss	(1,823,532)	(2,377,838)	(1,974,012)
Unrealized Loss	(12,393,020)	(10,194,487)	(4,712,002)
Interest Due and Accrued - Prior Year	<u>(248,513)</u>	<u>(313,065)</u>	<u>(482,729)</u>
Sub Total	<u>(15,050,831)</u>	<u>(13,091,161)</u>	<u>(7,477,923)</u>
NET INVESTMENT INCOME	<u>15,011,935</u>	<u>19,068,649</u>	<u>33,922,588</u>
Income Required:			
Annuity Savings Fund	397,699	372,743	560,041
Annuity Reserve Fund	668,565	634,820	595,960
Military Service Fund	102	184	0
Expense Fund	<u>1,813,075</u>	<u>1,717,158</u>	<u>1,486,535</u>
TOTAL INCOME REQUIRED	<u>2,879,442</u>	<u>2,724,904</u>	<u>2,642,536</u>
Net Investment Income	<u>15,011,935</u>	<u>19,068,649</u>	<u>33,922,588</u>
Less: Total Income Required	<u>2,879,442</u>	<u>2,724,904</u>	<u>2,642,536</u>
EXCESS INCOME TO THE PENSION RESERVE FUND	<u>\$12,132,493</u>	<u>\$16,343,745</u>	<u>\$31,280,051</u>

Essex Regional Retirement System

STATEMENT OF ALLOCATION OF INVESTMENTS OWNED (percentages by category)

FOR THE PERIOD ENDING DECEMBER 31, 2005

	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS	PERCENTAGE ALLOWED*
Cash	\$4,598,850	1.94%	
Short Term	116,320	0.05%	
Fixed Income	103,680	0.04%	
Equities	28,289,236	11.90%	
Pooled Domestic Equity Funds	85,763,650	36.09%	
Pooled International Equity Funds	37,256,265	15.68%	
Pooled Domestic Fixed Income Funds	53,065,407	22.33%	
Pooled Alternative Investment Funds	3,070,502	1.29%	5
Pooled Real Estate Funds	<u>25,367,933</u>	<u>10.68%</u>	10
GRAND TOTALS	<u>\$237,631,842</u>	<u>100.00%</u>	*at time of investment

All investments are reflected at their quoted market value.

For the year ending December 31, 2005, the rate of return for the investments of the Essex Regional Retirement System was 6.58%. For the five year period ending December 31, 2005, the rate of return for the investments of the Essex Regional Retirement System averaged 4.62%. For the 20-year period ending December 31, 2005, since PERAC began evaluating the returns of the retirement systems, the rate of return of the investments of the Essex Regional Retirement System was 10.13%.

Essex Regional Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

The Essex Regional Retirement System submitted the following supplementary investment regulations, which were approved by PERAC on:

May 20, 2004

16.08

In accordance with Investment Guideline 99-3, the Essex Regional Retirement Board may invest in the Massachusetts Technology Development Corporation Heritage Fund, L.P. As confirmed in a letter from MTDC's President, this fund is the successor fund to the MTDC Commonwealth Fund in which the Board has been a limited partner. The new fund will have the identical investment strategy as the previous one. The Board has submitted the required documents in support of this investment.

March 26, 2004

16.08

In accordance with Investment Guideline 99-3, the Essex Regional Retirement Board is authorized to invest in Ascent Venture Partners IV. The board has been a satisfied investor in Ascent Venture Partners III and the new fund will have the same portfolio management team and investment strategy as the fund in which the board is currently invested.

October 23, 2003

16.08

In accordance with PERAC Investment Guideline 99-2, the Essex Regional Retirement Board is authorized to make a minor modification to its large cap equity mandate with Freedom Capital Management Company. As part of its rebalancing program, the Board will supplement its current large cap equity separate account and its commingled Equity Style Fund with an allocation to Freedom's "Style-Weighted Concentrated Fund". This fund will incorporate the best ideas in both growth and value stocks, has the same S&P 500 benchmark, and is managed by the same team as Freedom's other large cap products

February 12, 2002

16.08

In accordance with Investment Guideline 99-2, the Essex Regional Retirement Board is modifying its fixed income mandate with State Street Research & Management and Financial Management Advisors. In order to save on management and custody fees, the mandates are changing from separate account management to commingled funds. The new funds are the "State Street Research Core Fixed Income Fund" and the "FMA High Yield Appreciation Limited Partnership". Both changes involve identical portfolio management teams and investment objectives.

Essex Regional Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

July 26, 2000

We have received your Board's response to PERAC Memo #44/1999 regarding Supplemental Investment Regulations. In accordance with your decision, self-imposed restrictions on your Board's percentage of holdings in specific asset classes have been rescinded. Your Board must, however, make asset allocation decisions subject to your fiduciary duty.

Please note that the restrictions pertaining to real estate and alternative investments contained in 840 CMR 19.01 remain in effect.

January 7, 2000

16.08

In accordance with PERAC Investment Guideline 99-3, the Essex County Retirement Board may invest in Boston Millennia Partners II, L.P. The board is an investor in Boston Millennia Partners I and has submitted the required documentation in support of this request.

June 30, 1998

20.0(1)

Venture capital investments shall not exceed 3% of the total market value of the portfolio at the time of the investment provided that in any system with assets in excess of nineteen million dollars, venture capital investments may be made up to an amount equal to 5% of the total market value of the portfolio at the time of investment, shall be considered a separate asset class, and provided further that:

(a) the board does not participate in the selection of the personnel responsible for making venture capital investments or otherwise exercise discretion in business affairs and should this be required, prior to any participation by the board, the board shall consult with PERAC to determine the appropriate course of action;

(b) such personnel retain authority in the decision making process, and

(c) should an investment in venture capital result in the direct ownership of securities, such shall be permitted only until such time as divestiture is prudent.

20.09(2)

Venture capital investments shall only be made in venture capital funds operated by venture capital firms having their principal places of business in the United States.

20.09(3)

All venture capital investments shall be made in companies which have their principal places of business in the United States.

Essex Regional Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

September 3, 1997

20.08(e)

Enrollment in the Securities Lending Program offered by Northern Trust Company for the Sector Plus Group Trust provided that the lending of securities is limited to brokers, dealers, and financial institutions and that the loan is collateralized by cash or United States Government securities according to applicable regulatory requirements.

January 25, 1996

21.01(3)

Futures Contracts other than as follows:

(a) Forward Currency Contracts may be written against securities in the international portfolio by an investment advisor registered under the Investment Advisors Act of 1940 and who has been granted a waiver from PERAC for international investments.

(b) Forward Currency Contracts may be written against securities in the international portfolio to a maximum of twenty-five percent (25%) of the international portfolio's non-dollar holdings at market value. Speculative currency positions unrelated to underlying portfolio holdings are strictly prohibited.

February 10, 1994

16.02(4)

The board may employ a custodian bank and may charge such expenses against earned income from investments provided that such expenses shall not exceed in any one year .08% of the value of the fund.

20.04(1)

United States based corporations and equities of foreign corporations.

20.07(5)

Equity investments shall be made only in securities listed on a United States stock exchange, traded over the counter in the United States, or listed and traded on a foreign exchange.

March 30, 1989

20.06(8)

Sales of fixed income investments with maturities exceeding one year shall not exceed 150% of the market value of all fixed income obligations in any twelve-month period, excluding cash and short term obligations.

20.07(6)

Sales of equity investments shall not exceed 100% of the average market value of all equity holdings in any twelve-month period.

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 1 - THE SYSTEM

The plan is a contributory defined benefit plan covering all Essex Regional Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

Instituted in 1937, the System is a member of the Massachusetts Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Membership in the plan is mandatory immediately upon the commencement of employment for all permanent, full-time employees.

The system provides for retirement allowance benefits up to a maximum of 80% of a member's highest three year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation, and group classification.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65 (for certain hazardous duty and public safety positions, normal retirement is at age 55).

A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. The average retirement benefit is approximately 75 - 85% pension and 15 - 25% annuity.

Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Members joining the retirement system after January 1, 1979 must contribute an additional 2% on regular compensation earned at a rate in excess of \$30,000. The percentage rate is keyed to the date upon which an employee's membership commences. These deductions are deposited in the Annuity Savings Fund and earn interest at a rate determined by the Executive Director of PERAC according to statute. When a member's retirement becomes effective, his/her deductions and related interest are transferred to the Annuity Reserve Fund. Any cost-of-living adjustment granted between 1981 and 1997 and any increase in other benefits imposed by state law during that period are borne by the state.

The pension portion of any retirement benefit is paid from the Pension Fund of the System. The governmental unit employing the member must annually appropriate and contribute the amount of current year pension payments as indicated on the most recent funding schedule as approved by PERAC's Actuary. Until recently, retirement systems were paying only the actual retirement

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

benefits that were due each year. Systems had no statutory authorization to put aside any money for the future benefits of employees who are now working. Large unfunded liabilities resulted from operating upon this pay-as-you-go basis. In 1977, legislation authorized local governments to appropriate funds to meet future pension obligations.

In 1983, additional legislation was passed requiring the transfer of investment earnings (in excess of the amount credited to member accounts) into the Pension Reserve Fund. These initiatives have significantly reduced the rate of growth of the retirement systems' unfunded liabilities, and in some systems have actually eliminated such liability.

Administrative expenses are funded through investment income of the system.

Members who become permanently and totally disabled for further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors including: whether or not the disability is work related, the member's age, years of creditable service, level of compensation, veteran's status, and group classification.

Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive either zero (0%) percent, fifty (50%) percent, or one hundred (100%) percent of the regular interest which has accrued upon those deductions. Survivor benefits are extended to eligible beneficiaries of members whose death occurs prior to or following retirement.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Executive Director of Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Voluntary contributions, redeposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Essex Regional Retirement System submitted the following supplementary membership regulations, which were approved by PERAC on:

August 2, 2004

In cases where overnight travel and accommodations are required, the Board is authorized to approve reimbursements related to reasonable and necessary expenses incurred the day before the scheduled event and the day after the scheduled event. "Scheduled event" is meant the event giving rise to the legitimate travel attendance.

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

SUPPLEMENTARY MEMBERSHIP REGULATIONS, CONTINUED

September 9, 2003

Travel Regulation

The Board has adopted a Supplementary Travel Regulation under the provisions of G.L. c. 7, § 50 and G.L. c. 32, § 21(4). (Regulation available upon written request.)

September 24, 1996

Membership: That an employee must work a minimum of twenty hours per week to meet the requirements of membership in the retirement system. A permanent part-time employee who does not work a fixed number of hours per week shall become a member of the system after a period of ninety (90) days if his average work week calculated at the end of the ninety (90) day period averages twenty hours or more.

Creditable Service: That a full-time employee will receive one (1) full year of creditable service for each year employed. A part-time employee whose position has always been part-time is granted full creditable service. A part-time employee who becomes full-time has the part-time service prorated.

Membership—Elected Officials: That if an elected official is not a member of the retirement system before their election by popular vote, they do not have to join the system; but they may join by applying for membership, in writing, within ninety (90) days of assuming their elective office.

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 4 - ADMINISTRATION OF THE SYSTEM

The System is administered by a five person Board of Retirement consisting of the Chairman who shall be elected by the other four board members and appointed by them as chief executive officer, a second member elected by the advisory council, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four board members.

Chairman:	Timothy Bassett	Term Expires:	12/31/2008
Advisory Council Member:	James Cashman	Term Expires:	12/31/2006
Elected Member:	William Martineau	Term Expires:	12/31/2006
Elected Member:	Glenn Morse	Term Expires:	2/1/2008
Appointed Member:	Katherine O'Leary	Term Expires:	6/30/2009

The Board members are required to meet at least once a month. The Board must keep a record of all of its proceedings. The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The board must annually file a financial statement of condition for the system with the Executive Director of PERAC.

The investment of the system's funds is the responsibility of the Board. All retirement allowances must be approved by the Retirement Board and are then submitted to the PERAC Actuary for verification prior to payment. All expenses incurred by the System must be approved by at least two members of the Board.

The following retirement board members and employees are bonded by an authorized agent representing a company licensed to do business in Massachusetts as follows:

Chairman:)	
Advisory Council Member:)	Fiduciary Insurance \$50,000,000
Elected Member:)	Fidelity Bond \$1,000,000
Appointed Member:)	MACRS policy
Staff Employee:)	

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by The Segal Company as of January 1, 2004.

The actuarial liability for active members was	\$163,318,735
The actuarial liability for terminated members was	4,682,268
The actuarial liability for retired members was	<u>165,395,219</u>
The total actuarial liability was	333,396,222
System assets as of that date were	<u>229,852,971</u>
The unfunded actuarial liability was	<u>\$103,543,251</u>
 The ratio of system's assets to total actuarial liability was	 68.9%
As of that date the total covered employee payroll was	\$93,404,002

The normal cost for employees on that date was 8.58% of payroll

The normal cost for the employer was 6.93% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.50% per annum

Rate of Salary Increase: 5.00% per annum

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2004

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Cov. Payroll ((b-a)/c)
1/1/2004	\$229,852,971	\$333,396,222	\$103,543,251	68.9%	\$93,404,002	110.9%
1/1/2002	218,346,198	287,390,715	69,044,517	76.0%	85,005,338	81.2%
1/1/2000	190,363,700	253,847,100	63,483,400	75.0%	69,525,900	91.3%
1/1/1999	180,034,700	268,386,000	88,351,300	67.1%	89,645,300	98.6%
1/1/1998	151,293,900	245,965,100	94,671,200	61.5%	85,785,000	110.4%

Essex Regional Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE THREE YEAR PERIOD ENDING DECEMBER 31, 2005

NOTE 6 - MEMBERSHIP EXHIBIT

Retirement in Past Years	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Superannuation	44	16	57	2	48	7	32	64	8	73
Ordinary Disability	1	2	4	1	2	0	0	1	0	1
Accidental Disability	3	0	3	0	1	0	0	4	1	6
Total Retirements	48	18	64	3	51	7	32	69	9	80
Total Retirees, Beneficiaries and Survivors	1,400	1,425	1,477	1,454	1,509	1,444	1,480	1,501	1,498	1,580
Total Active Members	2,917	3,251	3,401	3,027	3,135	3,271	3,300	3,146	3,015	2,987
Pension Payments										
Superannuation	\$6,959,721	\$7,503,419	\$8,005,617	\$8,683,752	\$9,574,446	\$9,898,380	\$10,527,968	\$11,878,170	\$13,004,480	\$13,806,107
Survivor/Beneficiary Payments	804,619	784,460	779,237	799,789	899,405	937,488	977,893	1,037,535	1,127,176	1,195,411
Ordinary Disability	227,048	248,552	313,518	304,553	312,949	309,718	288,299	290,690	336,560	281,611
Accidental Disability	1,437,464	1,526,864	1,539,724	1,565,189	1,627,756	1,677,851	1,741,172	1,832,263	2,012,159	2,114,484
Other	<u>1,238,145</u>	<u>1,307,488</u>	<u>1,410,249</u>	<u>1,479,808</u>	<u>769,809</u>	<u>1,590,101</u>	<u>936,365</u>	<u>978,071</u>	<u>1,017,337</u>	<u>1,164,938</u>
Total Payments for Year	<u>\$10,666,997</u>	<u>\$11,370,783</u>	<u>\$12,048,345</u>	<u>\$12,833,091</u>	<u>\$13,184,363</u>	<u>\$14,413,537</u>	<u>\$14,471,698</u>	<u>\$16,016,730</u>	<u>\$17,497,712</u>	<u>\$18,562,552</u>

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